

Looking for something to read? See our [Reading List](#); these books, separated by category, are ones we find interesting and insightful. We will be adding to the list over time.

[Posted: October 30, 2023—9:30 AM EDT] Global equity markets are higher this morning. In Europe, the Euro Stoxx 50 is up 0.9% from its prior close. In Asia, the MSCI Asia Apex 50 Index closed up 0.4%. Chinese markets were higher, with the Shanghai Composite up 0.1% from its previous close and the Shenzhen Composite up 1.4%. U.S. equity index futures are signaling a higher open.

With 245 companies having reported so far, S&P 500 earnings for Q3 are running at \$57.50 per share, compared to estimates of \$57.42, which is up 1.7% from Q2 2023. Of the companies that have reported thus far, 78.8% have exceeded expectations while 16.7% have fallen short of expectations.

The Confluence macro team publishes a plethora of research reports and multimedia offerings on a weekly and quarterly basis, all available on our [website](#). We highlight recent publications below, with new items of the day emphasized in bold:

- [Bi-Weekly Geopolitical Report](#) (10/16/2023) (with associated [podcast](#)): “What Shall We Call the New Era?”
- [Weekly Energy Update](#) (10/19/2023): The situation in the Middle East remains fraught with risk, supporting crude oil prices. Despite continued record crude oil production, commercial inventories declined this week while refinery activity rose modestly. *Note: the next edition of this report will be published on November 2.*
- [Asset Allocation Quarterly – Q4 2023](#) (10/19/2023): Discussion of our asset allocation process, Q4 2023 portfolio changes, and our outlook for the markets.
- **[Asset Allocation Q4 2023 Rebalance Presentation](#) (10/30/2023): Video presentation featuring the Asset Allocation Committee as they review the asset allocation strategies, recent portfolio changes, and the current macro environment.**
- [Asset Allocation Bi-Weekly](#) (10/23/2023) (with associated [podcast](#)): “A Regime Change in Bonds?”
- [Confluence of Ideas podcast](#) (8/22/2023): “The Economics of Defense in Great Power Competition”
- [Keller Quarterly](#) (October 2023)
- [Business Cycle Report](#) (10/26/23)

Our *Comment* today opens with the latest on the Israel-Hamas conflict. We next review a wide range of other international and U.S. developments with the potential to affect the financial

markets today, including a preview of the Bank of Japan's important new policy meeting starting today and a discussion of the U.S. labor market as the auto industry's strikes look like they're finally drawing to a close.

Israel-Hamas Conflict: Over the weekend, the Israeli Defense Forces [launched what Prime Minister Netanyahu called the "second stage" of Israel's war against the terrorist Hamas government in the Gaza Strip](#). While the initial stage focused on airstrikes targeted against Hamas leaders and military forces, the new stage has sent IDF ground forces into Gaza on extended incursions. Meanwhile, Netanyahu [is facing increased political peril for his perceived reluctance to take responsibility for the October 7 attacks](#) by Hamas that started the conflict. Over the weekend, Netanyahu blamed Israeli intelligence services for not warning him of the attacks beforehand, but he was forced to backtrack and apologize after his statement sparked a wave of criticism.

- So far, Israel's new, extended ground incursions appear to be more focused and limited than many observers feared, suggesting Israeli leaders [have heeded U.S. advice not to launch the feared massive ground invasion until they have a set of clear, realistic objectives and a plan to achieve them](#). The relative restraint being shown by Israel right now is a welcome development that could lower the risk of the conflict expanding into a regional conflagration.
- Nevertheless, Iranian-backed Hezbollah fighters in southern Lebanon [continue to launch missile barrages into Israel, prompting Israeli retaliatory strikes and keeping alive the risk of escalation](#). Israel today also reportedly [carried out airstrikes against military targets in Syria and against Palestinian targets in the West Bank](#).

Russia-Ukraine War: Media analysts [are reporting a surge in on-line disinformation aimed at discrediting Ukrainian President Zelensky and undermining Western support for military aid to Ukraine](#). The disinformation, which is believed to have been placed by Russia, has appeared mostly on social media networks. Nevertheless, U.S. and European officials are vowing continued support for Kyiv no matter what.

China-United States: U.S. semiconductor giant Broadcom (AVGO, \$838.36) and cloud software firm VMware (VMW, \$142.20) [said they will miss their goal to complete their \\$69-billion merger today, as Chinese authorities still have not provided their approval](#). The firms still have time to complete the deal before their final contracted deadline of November 26, but there is increasing concern that China will continue to slow-walk its approval or even scuttle the deal in retaliation for the Biden administration's latest clampdown on transferring U.S. advanced semiconductor technology to China.

China: New analysis by the *Financial Times* suggests foreign direct investment in September [was down a whopping 34% year-over-year](#), marking the largest decline since monthly records became available in 2014 and leaving monthly FDI at just \$10 billion. FDI in China has now been down by double-digit percentages on a year-over-year basis every month since May, reflecting increased pessimism regarding China's structural economic headwinds (including poor consumer demand, high levels of debt, bad demographics, and foreign de-coupling), along with President Xi's statist economic policies.

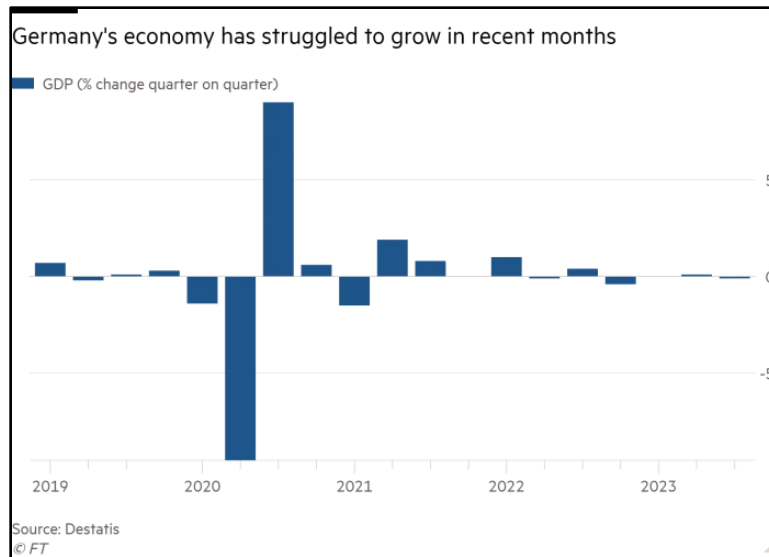


Japan: The Bank of Japan [begins a two-day policy meeting today](#), and when it releases its decision tomorrow, many observers believe it will signal that it is finally preparing to drop its longstanding policy of negative short-term interest rates and/or further modify its yield-curve control policy. After expanding its tolerance band for 10-year government bond yields to 1.0% in July, some observers expect the policymakers to widen the band to 1.5%, while others believe they will abandon the limit entirely.

- Such policy modifications are increasingly likely as the yen (JPY) continues to weaken toward multi-decade lows.
- Recently, Japanese 10-year government bond yields have risen near 0.90%, suggesting increased market consensus that the policy band will be widened.

European Union-Australia: EU and Australian officials [hit an impasse in their negotiations for a free-trade deal, likely postponing any new talks or agreement until at least 2025](#). Sticking points reportedly included the EU's reluctance to open its market to Australian beef and sheep, and Australian resistance to the EU's food-labeling requirements. The failed deal is yet another example of how the last three decades' trend toward ever-greater globalization has largely ended.

Germany: Third-quarter gross domestic product [fell by a seasonally adjusted 0.1%](#), slightly better than the expected decline but still almost enough to reverse the prior period's small increase. Germany's economy continues to stagnate in the face of headwinds such as weak foreign demand, high inflation, and rising interest rates. GDP in the third quarter was down 0.3% from the same period one year earlier.



U.S. Auto Industry: On Saturday, the United Auto Workers [reached a tentative agreement on a new labor contract with giant automaker Stellantis \(STLA, \\$18.04\)](#), days after reaching a separate deal with Ford (F, \$9.96). The agreements have raised hopes that the UAW's historic, six-month strike against the top three U.S. automakers may come to an end soon. However, it's important to remember that General Motors (GM, \$27.22) continues to hold out. To encourage GM to get in line with Ford and Stellantis, the union over the weekend expanded its strike against the company to include one of its key factories in Tennessee.

- The tentative deals with Ford and Stellantis still need to be voted on and approved by their respective union workforces.
- However, the overall contours of those deals suggest UAW workers at the firms will get a substantial pay raise spread over the life of the contract, better retirement and other benefits, improved work conditions, and job protections.
- As we have argued in the past, the labor shortages spawned by the mass retirement of Baby Boomers and other hurdles to employment during the pandemic have given workers greater bargaining power, prompting increased union demands and fast-growing wage rates.
 - Over time, that will likely shift a greater share of national income toward workers and away from capital owners. This will likely erode corporate profit margins.
 - Nevertheless, the impact on potential economic growth is still indeterminate. Since workers tend to spend a greater share of their income, stronger wage growth could potentially boost consumer demand. Companies might also increase their investment in labor-saving equipment, offsetting some of the investment cuts they might otherwise adopt as profit margins tighten.

U.S. Retirement Investment Industry: Under the Department of Education's new rules for the Free Application for Federal Student Aid, pre-tax investments in retirement accounts [will no longer be counted in a family's income for purposes of calculating financial aid](#). The change is

expected to result in increased financial aid of \$5,000 to \$10,000 per year for many families. Of course, it could also incentivize continued or increased retirement investing among those with kids in college.

U.S. AI Regulation: Using emergency powers in the Defense Production Act, President Biden [issued an executive order today that will force major artificial-intelligence companies to notify the government](#) when developing any system that poses a “serious risk to national security, national economic security or national public health and safety.” While rapid developments in AI are widely seen as promising great economic and social benefits, the new executive order [aims to address various risks until a slow-moving Congress can study the technology and come up with a comprehensive regulatory scheme.](#)

U.S. Economic Releases

There were no economic releases prior to the publication of this report. The table below lists the economic releases and/or Fed events scheduled for the rest of the day.

Economic Releases						
EST	Indicator			Expected	Prior	Rating
10:30	Dallas Fed Manufacturing Activity	m/m	Oct	-16.0	-18.1	**
Federal Reserve						
No Fed speakers or events for the rest of today						

Foreign Economic News

We monitor numerous global economic indicators on a continuous basis. The most significant international news that was released overnight is outlined below. Not all releases are equally significant, thus we have created a star rating to convey to our readers the importance of the various indicators. The rating column below is a three-star scale of importance, with one star being the least important and three stars being the most important. We note that these ratings do change over time as economic circumstances change. Additionally, for ease of reading, we have also color-coded the market impact section, which indicates the effect on the foreign market. Red indicates a concerning development, yellow indicates an emerging trend that we are following closely for possible complications, and green indicates neutral conditions. We will add a paragraph below if any development merits further explanation.

Country	Indicator			Current	Prior	Expected	Rating	Market Impact
ASIA-PACIFIC								
Australia	Retail Sales	m/m	Sep	0.9%	0.2%	0.3%	***	Equity bullish, bond bearish
South Korea	Discount Store Sales	y/y	Sep	10.0%	-8.4%		*	Equity and bond neutral
	Depart. Store Sales	y/y	Sep	3.1%	-4.9%		*	Equity and bond neutral
	Retail Sales	y/y	Sep	9.5%	3.3%		**	Equity and bond neutral
EUROPE								
Eurozone	Consumer Confidence	m/m	Oct F	-17.9	-17.9	--	**	Equity and bond neutral
	Economic Confidence	m/m	Oct	93.3	93.3	93.4	***	Equity and bond neutral
	Industrial Confidence	m/m	Oct	-9.3	-9.0	-8.9	***	Equity bearish, bond bullish
	Services Confidence	m/m	Oct	4.5	4.0	1.1	**	Equity and bond neutral
Germany	GDP NSA	y/y	3Q P	-0.8%	-0.6%	-0.4%	**	Equity and bond neutral
	GDP WDA	y/y	3Q P	-0.3%	-0.2%	0.0%	**	Equity and bond neutral
UK	Mortgage Approvals	m/m	Sep	43.3k	45.4k	44.5k	***	Equity and bond neutral
Switzerland	KOF Leading Indicator	m/m	Oct	95.8	95.9	95.8	**	Equity and bond neutral
	Domestic Sight Deposits CHF	w/w	27-Oct	463.1b	469.7b	--	*	Equity and bond neutral
	Total Sight Deposits CHF	w/w	27-Oct	472.1b	478.8b	--	*	Equity and bond neutral
AMERICAS								
Brazil	FGV Inflation IGPM	y/y	Oct	-4.57%	-5.97%	-4.45%	***	Equity and bond neutral

Financial Markets

The table below highlights some of the indicators that we follow on a daily basis. Again, the color coding is similar to the foreign news description above. We will add a paragraph below if a certain move merits further explanation.

Fixed Income	Today	Prior	Change	Trend
3-mo Libor yield (bps)	565	564	1	Up
3-mo T-bill yield (bps)	530	531	-1	Up
TED spread (bps)	LIBOR and the TED Spread have been discontinued.			
U.S. Sibor/OIS spread (bps)	538	538	0	Up
U.S. Libor/OIS spread (bps)	539	539	0	Up
10-yr T-note (%)	4.87	4.85	0.02	Flat
Euribor/OIS spread (bps)	395	394	1	Up
Currencies	Direction			
Dollar	Down			Up
Euro	Up			Down
Yen	Flat			Down
Pound	Flat			Down
Franc	Down			Down

Commodity Markets

The commodity section below shows some of the commodity prices and their change from the prior trading day, with commentary on the cause of the change highlighted in the last column.

DOE Inventory Report	Price	Prior	Change	Explanation
Energy Markets				
Brent	\$89.49	\$90.48	-1.09%	
WTI	\$84.45	\$85.54	-1.27%	
Natural Gas	\$3.33	\$3.48	-4.34%	Supply Optimism
Crack Spread	\$20.78	\$20.47	1.49%	
12-mo strip crack	\$23.50	\$23.63	-0.57%	
Ethanol rack	\$2.30	\$2.30	-0.37%	
Metals				
Gold	\$1,995.38	\$2,006.37	-0.55%	
Silver	\$23.17	\$23.12	0.22%	
Copper contract	\$370.45	\$364.60	1.60%	
Grains				
Corn contract	\$479.50	\$480.75	-0.26%	
Wheat contract	\$568.00	\$575.50	-1.30%	
Soybeans contract	\$1,320.75	\$1,319.50	0.09%	
Shipping				
Baltic Dry Freight	1,563	1,662	-99	

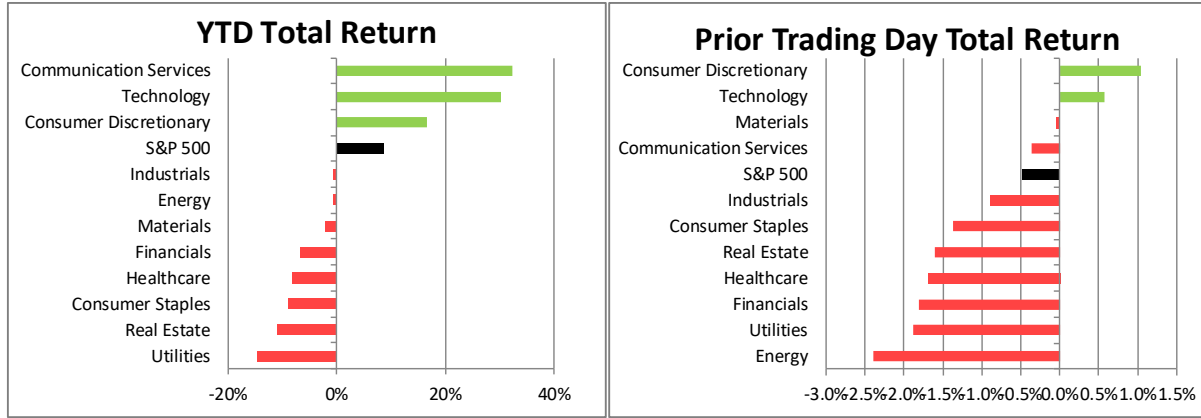
Weather

The 6-10 and 8-14 day forecasts predict warmer-than-normal temperatures for most of the country, with cooler temperatures expected in New England. The precipitation outlook shows wetter-than-normal conditions in most states, with dry conditions expected in the Southwest.

There are currently two atmospheric disturbances in the Atlantic Ocean, but neither are expected to develop into a major storm within the next 48 hours. One disturbance near the northwestern edge of the Bahamas has a 20% chance of becoming a cyclone in the next two days, while another in the southeastern Caribbean Sea has a 10% chance. On average, Atlantic hurricane activity peaks on September 15.

Data Section

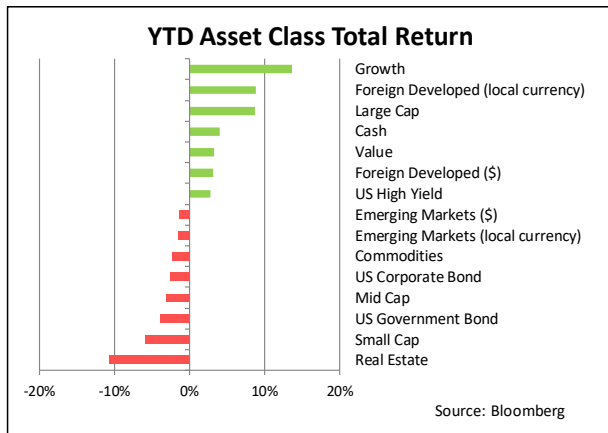
U.S. Equity Markets – (as of 10/27/2023 close)



(Source: Bloomberg)

These S&P 500 and sector return charts are designed to provide the reader with an easy overview of the year-to-date and prior trading day total return. Sectors are ranked by total return; green indicating positive and red indicating negative return, along with the overall S&P 500 in black. These charts represent the new sectors following the 2018 sector reconfiguration.

Asset Class Performance – (as of 10/27/2023 close)

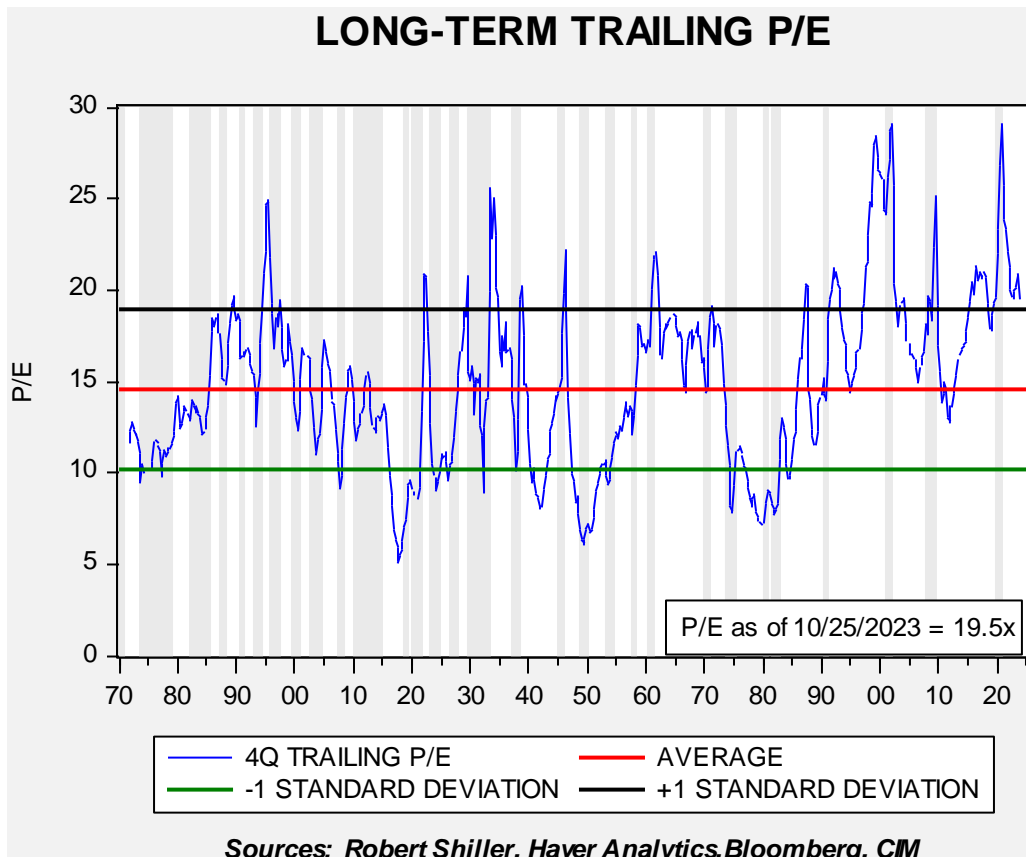


This chart shows the year-to-date returns for various asset classes, updated daily. The asset classes are ranked by total return (including dividends), with green indicating positive and red indicating negative returns from the beginning of the year, as of prior close.

Asset classes are defined as follows: Large Cap (S&P 500 Index), Mid Cap (S&P 400 Index), Small Cap (Russell 2000 Index), Foreign Developed (MSCI EAFE (USD and local currency) Index), Real Estate (FTSE NAREIT Index), Emerging Markets (MSCI Emerging Markets (USD and local currency) Index), Cash (iShares Short Treasury Bond ETF), U.S. Corporate Bond (iShares iBoxx \$ Investment Grade Corporate Bond ETF), U.S. Government Bond (iShares 7-10 Year Treasury Bond ETF), U.S. High Yield (iShares iBoxx \$ High Yield Corporate Bond ETF), Commodities (Bloomberg total return Commodity Index), Value (S&P 500 Value), Growth (S&P 500 Growth).

P/E Update

October 26, 2023



Based on our methodology,¹ the current P/E is 19.5x, down 0.1x from last week. The multiple contracted modestly on improved earnings.

This report was prepared by Confluence Investment Management LLC and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward-looking statements expressed are subject to change. This is not a solicitation or an offer to buy or sell any security.

¹ This chart offers a running snapshot of the S&P 500 P/E in a long-term historical context. We are using a specific measurement process, similar to *Value Line*, which combines earnings estimates and actual data. We use an adjusted operating earnings number going back to 1870 (we adjust as-reported earnings to operating earnings through a regression process until 1988), and actual operating earnings after 1988. For the current quarter, we use the Bloomberg estimates which are updated regularly throughout the quarter; currently, the four-quarter earnings sum includes two actual quarters (Q1 and Q2) and two estimates (Q3 and Q4). We take the S&P average for the quarter and divide by the rolling four-quarter sum of earnings to calculate the P/E. This methodology isn't perfect (it will tend to inflate the P/E on a trailing basis and deflate it on a forward basis), but it will also smooth the data and avoid P/E volatility caused by unusual market activity (through the average price process). Why this process? Given the constraints of the long-term data series, this is the best way to create a long-term dataset for P/E ratios.